



**Office of the Attorney General
State of Texas**

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August 27, 1996

The Honorable Barry B. Telford
Chair, Committee on Pension and Investments
Texas House of Representatives
P.O. Box 2910
Austin, Texas 78768-2910

Letter Opinion No. 96-095

Re: Whether a provision in a pooled income fund trust agreement that authorizes the distribution of mutual fund short term capital gains as income would fundamentally depart from Texas law (RQ-901)

Dear Representative Telford:

You ask whether a provision in a pooled income fund trust agreement that authorizes the distribution of mutual fund short term capital gains as income would fundamentally depart from Texas law. You explain that under the terms of the trust agreement that establishes the pooled income fund, a donor pledges assets to charity, but the charity does not receive the principal or income until the donor's death. During the donor's lifetime, the donor retains an income interest in the assets. According to your letter, a charitable pooled income fund is given favorable federal tax treatment.

You state that smaller pooled income funds often invest their assets in mutual funds. Mutual fund distributions include short term capital gains realized by the mutual fund. In some instances, the trust agreement may specifically authorize the trustee to distribute mutual fund short term capital gains dividends to the income beneficiary. You state that for a pooled income fund to benefit from federal tax advantages, an income distribution from the fund must conform with local law: "If a trust fund is seen as fundamentally departing from local laws, then it will not be afforded its favorable federal tax status." Thus, you ask whether a provision in a pooled income fund trust agreement that authorizes the distribution of mutual fund short term capital gains as income would fundamentally depart from Texas law.

The Texas Trust Code, Property Code, Title 9, Subtitle B, (the "Trust Code") governs express trusts in Texas. As a general matter, the Trust Code is not intended to usurp trust agreement terms. If provisions of the Trust Code and the terms of a trust conflict, the terms of the trust control, "except the settlor may not relieve a corporate

trustee from the duties, restrictions, and liabilities under Section 113.052 or 113.053." Property Code § 111.002(a); *see also id.* § 113.059(b).¹ Subchapter D, which governs the allocation of principal and income, reflects this general principal. Section 113.101(a) provides that the trustee shall

administer the trust with due regard for the interests of income beneficiaries and remaindermen with respect to the allocation of receipts and expenditures by crediting a receipt or charging an expenditure to income or principal or partly to each

(1) *in accordance with the terms of the trust agreement;*

(2) *in the absence of any contrary terms of the trust agreement, in accordance with this subtitle; or*

(3) if neither of the preceding rules of administration is applicable, in accordance with what is reasonable and equitable in view of the interests of those entitled to income and to principal. [Emphasis added.]

Thus, under Texas law, the allocation of a receipt is governed in the first instance in accordance with the terms of the trust agreement. The provisions of subchapter D control the allocation of items to income or principal only when the trust agreement is silent. For this reason, we do not believe that a trust agreement provision allocating mutual fund short term capital gains to income would fundamentally depart from Texas law.²

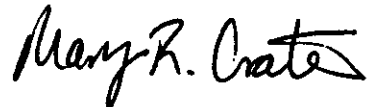
¹Trust Code, sections 113.052 and 113.053 limit a trustee's authority to lend trust funds and purchase or sell trust property.

²In the absence of a trust instrument term, section 113.104 governs corporate distributions. Subsection (a) states the general rule that, except as provided by subsections (b) and (c), all corporate distributions are income. One of these exceptions, subsection (c)(3), deals expressly with distributions of regulated investment companies, *i.e.* mutual funds. It was modeled on section 6(c) of the Uniform Principal and Income Act of 1962. *See* UNIF. PRINCIPAL AND INCOME ACT REVISED 1962 ACT § 6(c), 7B U.L.A. 163 (1983). Because you ask about situations in which there is a trust instrument provision governing the allocation of mutual fund short term capital gains, we do not address this statute.

S U M M A R Y

A provision in a pooled income fund trust agreement that authorizes the distribution of mutual fund short term capital gains as income would not fundamentally depart from Texas law.

Yours very truly,

A handwritten signature in black ink, appearing to read "Mary R. Crouter". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Mary R. Crouter
Assistant Attorney General
Opinion Committee